

Comments of LDDS WorldCom
CC Docket No. 96-150
August 26, 1996

the hortatory language of Section 274(e)(3). The rule should include a provision that authorizes the Commission to take any action, up to and including revoking an RBOC's authorization to provide the service in question, if either statutory requirement is violated by the RBOC in any way. This provision will have little meaning unless the Commission demonstrates that it can and will be applied effectively and forcefully.

In addition, the Commission should adopt a cost allocation rule that requires the RBOCs, where they provide services and facilities on an integrated basis, to provide those same inputs to their own internal operations only at the same rates and terms that they are made available to all other carriers. Where the RBOCs' charge different rates for these inputs to different unaffiliated carriers, the highest rate must be paid by the RBOCs' integrated operations. This kind of rule will help ensure that the RBOCs are passing on to consumers the full cost of necessary inputs upon which the RBOCs' competitors must rely.

c. FCC jurisdiction

Finally, the FCC tentatively concludes in the Notice that the 1996 Act gives the Commission jurisdiction over all interLATA services, both interstate and intrastate.³⁷ The FCC seeks comments on the states' role in implementing accounting safeguards.³⁸

As WorldCom stated in its comments in CC Docket No. 96-149, consistent national rules are necessary with respect to the non-accounting and structural separation

³⁷ Notice at para. 48.

³⁸ Notice at para. 49.

safeguards that are applicable to the RBOCs.³⁹ The same is true for the accounting and cost allocation safeguards to be adopted in this proceeding. The very framework of the Act in general, and Sections 271 and 272 in particular, moves away from distinctions between interstate and intrastate services, and toward a national set of rules that apply across states and among RBOCs. While the states certainly have a major role to play in implementing the federal rules, and in supplementing those rules with any additional requirements necessary to protect local ratepayers, the states cannot depart from the federal safeguards. The FCC has been given plenary jurisdiction over all interLATA activities of the RBOCs, both interstate and intrastate.

C. Section 276 (Payphone Services)

[Notice, paras. 57-61]

Section 276(a)(1) of the Act states that the RBOCs cannot subsidize their payphone services "directly or indirectly" from their local exchange and access services.⁴⁰ Additionally, Section 276(b)(1)(C) states that accounting safeguards for payphone service must "at a minimum" include safeguards equal to those employed by the Commission in its Computer III proceeding.⁴¹ In its Notice, the FCC proposes to adopt safeguards that are identical to those

³⁹ Comments of LDDS WorldCom, CC Docket No. 96-149, at 11.

⁴⁰ 1996 Act, Section 276(a)(1).

⁴¹ 1996 Act, Section 276(b)(1)(C).

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in Computer III.⁴² The Commission also seeks comment on its suggestion to reclassify payphone service as nonregulated activity separated from other regulated services.⁴³

The Act suggests that merely adopting Computer III safeguards would be a bare minimum that may not be enough to prevent unlawful subsidization of payphone services. WorldCom believes that the Commission should do more than merely the minimum. Indeed, with all subsidization, "directly or indirectly," prohibited by the statute, the Computer III rules alone likely are not sufficient to protect ratepayers. One necessary addition to those rules is to require the RBOCs to classify their payphone service as a nonregulated activity for accounting purposes, for the same reasons that the RBOCs' interLATA services should be classified this way. Without this rule, it will be far more difficult for the Commission to separate out the costs of payphone service from the RBOCs' other regulated costs.

⁴² Notice at para. 58.

⁴³ Notice at para. 59.

III. THE BELL COMPANIES' SEPARATED OPERATIONS MUST BE REQUIRED TO ABIDE BY STRENGTHENED ACCOUNTING AND AFFILIATE TRANSACTION REQUIREMENTS THAT WILL ENSURE THAT RATEPAYERS AND COMPETITORS ARE NOT SUBJECT TO UNLAWFUL DISCRIMINATION AND CROSS-SUBSIDIZATION

A. General

[Notice, paras. 62-66]

The Notice next turns to "the accounting safeguards needed to prevent subsidization where telephone operating companies do business with their nonregulated and regulated affiliates."⁴⁴ As with its Part 64 cost allocation rules, the Commission tentatively concludes that its Part 32 affiliate transaction rules "generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services."⁴⁵ The Commission again worries that redesigning the RBOCs' internal accounting system for different affiliate transaction rules "would impose substantial costs on the carriers."⁴⁶ By the same token, the Commission is aware that "amending certain aspects of the affiliate transactions rules might provide more optimal protection against subsidization,"⁴⁷ and several modifications are suggested.

While WorldCom welcomes the proposed strengthening of the Commission's

⁴⁴ Notice at para. 63.

⁴⁵ Notice at para. 64.

⁴⁶ Notice at para. 64.

⁴⁷ Notice at para. 65.

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affiliate transaction rules, it remains a matter of concern that the Commission once again appears to be placing too much emphasis on any additional implementation costs that the RBOCs might incur. This factor is not found in the Act, and should not be found here. Nonetheless, WorldCom agrees wholeheartedly with the Commission's suggestion that the adoption of additional safeguards with "more optimal protection against subsidization" is in the public interest. Without the adoption and enforcement of strong structural separation requirements, the promise of effective and widespread local competition will be dashed even before it has a chance to begin.

B. Section 272

[Notice, paras. 67-94]

In its comments in CC Docket No. 96-149, WorldCom urges the Commission to enforce the Act's separation requirements by making the RBOCs' interLATA affiliate the basic retail entity for one-stop package offerings that include local and long distance service.⁴⁸ This separate affiliate could offer interLATA service in competition with other entities by buying exchange access from the operating company, and also offer local service by purchasing local service elements and wholesale services from the operating company. WorldCom demonstrated how this structure will foster the Act's mandate for full separation of the RBOCs' in-region interLATA services, while still permitting full-service retail competition to proceed. In the

⁴⁸ Comments of LDDS WorldCom, CC Docket No. 96-149, at 11-18.

section below, WorldCom will comment on some of the accounting safeguards issues related to the separate affiliate structure required by the Act.

1. Accounting Requirements [Notice, paras. 67-69]

Section 272(b)(2) of the Act requires that the RBOCs' affiliate "maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the [RBOCs]." ⁴⁹ To implement this provision, the Commission asks whether it should require the RBOCs' affiliates to utilize generally accepted accounting principles ("GAAP"). ⁵⁰

All RBOC accounting related to affiliate transactions must comply with generally accepted accounting principles. Among other things, GAAP will assist the RBOCs and the Commission to make sure that all transactions comply with the statutorily-mandated degree of separation. Anything less than GAAP would seriously weaken the requirements of Sections 271 and 272.

As is the case with the RBOCs' integrated operations, WorldCom also urges the Commission to require the RBOCs' separate affiliates to abide by the Uniform System of Accounts prescribed by Part 32 of the FCC's Rules. The use of USOA, which is more stringent and detailed than GAAP, will enable a much more accurate tracking of the way the RBOCs

⁴⁹ 1996 Act, Section 272(b)(2).

⁵⁰ Notice at para. 68.

provide their services to the public. The Act expressly gives the Commission authority to prescribe the specific manner of keeping separate accounts. The Commission should do whatever it takes to make sure that the degree of separation required by the Act is in fact implemented correctly by the RBOCs.

2. "Arms Length" Requirements [Notice, paras. 70-88]

Section 272(b)(5) of the Act requires that "all transactions" between the affiliate and the RBOC must be "on an arm's length basis," "reduced to writing," and "available for public inspection."⁵¹ The FCC asks whether its rules should require a compensatory price, and whether the transactions should be recorded in auditable form.⁵² The Notice also asks whether the transactions covered by this provision should include requests by RBOC affiliates to use their parents' local exchange or exchange access services, and whether these transactions should be made public.⁵³

The Commission must carry out the broad and deep separation called for in this and other provisions of the Act. In order for the separate affiliate to "operate independently" from the operating company,⁵⁴ complete with separate employees,⁵⁵ and in order for all

⁵¹ 1996 Act, Section 272 (b)(5).

⁵² Notice at para. 70.

⁵³ Notice at para. 75.

⁵⁴ 1996 Act, Section 272(b)(1).

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transactions between the RBOC and its affiliate to be placed on an arm's length basis,⁵⁶ obviously the RBOCs cannot offer combined packages of local and interLATA services through the efforts of its local exchange company and interLATA affiliate working together. The plain language of the Act rules out such a close, hand-in-glove relationship. Instead, as WorldCom explained in its comments in CC Docket No. 96-149, the RBOCs can provide bundled or jointly-marketed offerings of local and interLATA services only (1) through the interLATA affiliate, (2) with the interLATA affiliate obtaining the local exchange components on the same basis as its competitors.⁵⁷ Such a structure is the only practical way that each of the interrelated protections mandated by Section 272 lead to separate and independent local and long distance operations.

In terms of how the RBOC relates to its affiliate, obviously the prices established should fully compensate the other party. In order that this mandate can be verified, the transaction should be recorded in writing by the parties in an auditable form. Each transaction should be made available for public review and inspection. WorldCom agrees with the Commission's suggestion of Internet-based access to these transaction records.⁵⁸ The RBOCs and their affiliates should only be able to redact those portions of the transactions that can be

⁵⁵ 1996 Act, Section 272(b)(3).

⁵⁶ 1996 Act, Section 272(b)(5).

⁵⁷ Comments of LDDS WorldCom, CC Docket No. 96-149, at 11-18.

⁵⁸ Notice at para. 74.

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proven to be confidential. Finally, the Act specifies that "all transactions" are covered, which necessarily includes requests by an RBOC affiliate to use its parent's local exchange or exchange access services.

a. Identical valuation methods for assets and services

The FCC states that its current rules allow four methods of ascertaining value of asset transfers between RBOC and affiliate, and three methods of ascertaining value of services provided between RBOC and affiliate. In order to minimize the risks of cross-subsidization, and to meet the "arm's length" requirement of the Act, the Notice proposes to establish identical valuation methods for assets and services: where the RBOC is the seller, the tariffed rate or, if none is available, the higher of cost or estimated fair market value (FMV); where the RBOC is the buyer, the lower of cost or estimated FMV.⁵⁹

WorldCom believes that the FCC should adopt its proposed, tougher "identical valuation" methodology. This new approach will help reduce the economic incentives to underprice those RBOC services sold to affiliates, and to overprice the services the RBOC receives from the affiliate. Although the RBOCs undoubtedly will protest this strengthened methodology, WorldCom believes it will significantly lessen the chances that ratepayers and competitors will be harmed by unlawful and anticompetitive cross-subsidies.

b. Prevailing company prices

The FCC acknowledges that the RBOCs generally experience lower marketing and

⁵⁹ Notice at para. 78.

transactional costs for sales with their affiliates than for non-affiliate sales, and seeks comments on how to deal with this issue in determining fair market value.⁶⁰

By definition, RBOC-to-affiliate sales do not measure fair market value. Instead, affiliate transactions conducted on an arm's length basis should entail the same marketing efforts and transactional costs that are encountered in sales to non-affiliates. Rather than allowing the RBOCs to automatically use the "prevailing price" in affiliate transactions as the fair market value, the Commission should adopt its proposal to use the "identical valuation method" instead.

c. Estimates of FMV

In lieu of specifying the precise procedures or methodologies that the RBOCs must use to determine fair market value in affiliate transactions, the Commission proposes to allow the RBOCs to establish their own "good faith determination" of FMV.⁶¹ Otherwise, the Commission fears that "a more stringent approach would impose unnecessary burdens and costs on the BOCs."⁶² The Notice also asks whether the Commission should set certain open-ended criteria for the RBOCs to use, such as supporting valuation by "reasonable independent valuation methods," or by other "reasonable and appropriate methods."⁶³

Once again, WorldCom believes that the Commission's concern for the supposed

⁶⁰ Notice at para. 80.

⁶¹ Notice at para. 83.

⁶² Id.

⁶³ Notice at paras. 84-85.

implementation burdens placed on the RBOCs by the Act is misplaced. Obviously the RBOCs must shoulder some additional expense and effort to meet the Act's many new requirements. It is not the Commission's burden to pick and choose which costs must be borne, and which can be excused.

Allowing the RBOCs to set their own versions of fair market value, based solely on their own methods, will lead to inconsistent and confusing results that will only give the RBOCs significant cover and leeway to shift costs and discriminate. This result certainly is not contemplated anywhere in the Act. Instead, a uniform set of requirements for FMV should be established by the Commission and then applied to all the RBOCs across-the-board. Independent support for the RBOCs' valuation is also crucial.⁶⁴ Should extraordinary individual circumstances necessitate a different treatment for one or more of the RBOCs in one or more situations, the Commission's waiver process always remains a viable option.

d. Tariff-based valuation

The Notice also seeks comments on how to establish the RBOCs' tariff-based valuation method if the Commission no longer requires the filing of tariffs.⁶⁵

The Commission's concern appears to be premature because, at present, there is no pending Commission proposal in any rulemaking proceeding to eliminate the tariffing requirement for the RBOCs' local exchange and exchange access services. Nonetheless, to the

⁶⁴ For example, one measure of fair market value is the publicly-advertised price that an RBOC itself pays an unaffiliated entity for a particular item or service.

⁶⁵ Notice at para. 86.

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extent such a plan is being contemplated, WorldCom strongly urges the Commission to continue requiring local exchange and exchange access tariffs to be filed for the foreseeable future, while the RBOCs continue to retain their local exchange and access bottlenecks.⁶⁶

In the absence of an RBOC tariff, the Commission should fall back on its plan that the RBOC pay the higher of either cost or FMV. In addition, for purposes of determining FMV, where more than one entity is involved and more than one price being charged, the affiliate must be compelled to pay the highest price that any other entity willingly pays the operating company.

3. Application to InterLATA Telecommunications Affiliates [Notice, paras. 89-90]

The FCC proposes to apply its affiliate transaction rules to RBOC transactions with its interLATA services affiliates.⁶⁷

WorldCom wholeheartedly agrees that the FCC's current affiliate transaction rules should apply to the RBOCs' transactions with their affiliates. Moreover, additional measures should be adopted. For instance, the Commission should adopt special valuation methodologies

⁶⁶ LDDS WorldCom filed comments in CC Docket No. 96-61 which, among other things, supported the Commission's exercise of its new forbearance authority to allow, but not require, nondominant interexchange carriers unaffiliated with the RBOCs to refrain from filing federal tariffs. See Comments of LDDS WorldCom, CC Docket No. 96-61, filed April 25, 1996, at 2-17; Reply Comments of LDDS WorldCom, CC Docket No. 96-61, filed May 24, 1996, at 2-17.

⁶⁷ Notice at para. 89.

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that will recognize the regulated status of the affiliates on both sides of the transactions. In addition, the Commission should apply its cost allocation rules to prevent subsidization of information services and other nonregulated activities by telecommunications services. Both measures would heighten the protection of ratepayers and competition that is at the heart of the Section 271 and 272 requirements. Moreover, as WorldCom also urged in CC Docket No. 96-149, the Commission should require the RBOCs to report their earnings for each affiliate covered by Section 272 and for the operating company, so that the Commission can evaluate whether the RBOC is taking advantage of its ability to hide discriminatory pricing by moving its profit centers to the operating company.⁶⁸

4. Application to Joint Marketing [Notice, para. 91]

Section 272(g)(2) of the Act states that an RBOC may not "market or sell" its affiliate's interLATA services until the RBOC has received FCC authorization to provide interLATA services for the state in question.⁶⁹ Should the FCC decide in CC Docket No. 96-149 that an RBOC may share marketing personnel with its affiliate, the FCC here proposes to apply its cost allocation and affiliate transaction rules to any such joint marketing.

As WorldCom explained in its comments in CC Docket No. 96-149, Section

⁶⁸ See Comments of LDDS WorldCom, CC Docket No. 96-149, at 26-27.

⁶⁹ 1996 Act, Section 272(g)(2).

272(g)(2) does not authorize blanket joint marketing by the RBOCs.⁷⁰ The Act requires that all RBOC affiliate personnel, including marketing staff, operate independently from, and on an arm's length basis from, the operating company's marketing personnel. Thus, the Commission has no authority to allow the indiscriminate sharing of marketing personnel and services between the RBOC and its interLATA affiliate. Nonetheless, should the FCC decide -- incorrectly -- that the Act allows such sharing, then all pertinent cost allocation and affiliate transaction rules must apply to that joint marketing operation.

5. Audit Requirements [Notice, paras. 92-94]

Section 272(d) of the Act requires a biannual independent audit to determine whether the RBOC has complied with the 1996 Act, all regulations promulgated under the Act, and especially the separate accounting requirements imposed by Section 272(b).⁷¹ The Notice seeks comments on the Commission's proposal to require that the auditors file their reports with certain standard attestations.⁷²

WorldCom supports the Commission's audit proposal. However, the focus of that audit should be expanded to direct the auditor to determine, among other things, whether the RBOC has complied with Section 272(e)(3) (imputed access charges) and 272(e)(4) (facilities and

⁷⁰ Comments of LDDS WorldCom, CC Docket No. 96-149, at 15-18.

⁷¹ 1996 Act, Section 272(d)(1).

⁷² Notice at para. 93.

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services provided to non-affiliates on the same rates, terms, and conditions). In addition, the auditor should examine the earnings of each of the RBOCs and their affiliates separately to determine whether the RBOC somehow is evading the rules by pricing all its inputs to the affiliate at supracompetitive levels and then pocketing the excess.⁷³

C. Separated Operations Under Section 271

[Notice, paras. 118-119]

The Notice next turns to those interLATA telecommunications services that an RBOC may decide on its own to provide on a separated basis, such as out-of-region interLATA service. Noting that such services "present a potential for improper subsidization," the Commission tentatively concludes that its modified affiliate transaction rules should apply to transactions between each RBOC "and any interLATA telecommunications services affiliate it establishes."⁷⁴

WorldCom agrees with the Commission's proposal. Where the potential for cross-subsidies exists, the Commission must adopt and enforce rules to limit the potential for harm to ratepayers and competition.

⁷³ See Comments of LDDS WorldCom, CC Docket No. 96-149, at 26-27.

⁷⁴ Notice at para. 119.

**IV. THE EXISTENCE AND STRENGTH OF THE COMMISSION'S
NONSTRUCTURAL SAFEGUARDS SHOULD NOT DEPEND IN ANY WAY ON
THE STATUS OF THE COMMISSION'S FLAWED PRICE CAPS REGIME**

[Notice, paras. 120-124]

The Commission states that its accounting rules "will be shaped by our price cap regulations" because price caps keep the RBOCs' rates "reasonable."⁷⁵ The Notice speculates that a pure price caps system will "greatly diminish," if not eliminate altogether, the need for Part 64 accounting safeguards.⁷⁶

The Commission is wrong. Price caps may reduce some incentives to shift some costs, but certainly not all of them. Price caps also do nothing to prevent RBOC discrimination, which is another statutory mandate and another reason for needing strong accounting safeguards. In addition, price caps will not govern the wholesale rates that the RBOCs charge their affiliates and other carriers under Sections 251 and 252 of the Act. Moreover, price caps do not affect the prices of affiliate transactions, or the incentives to shift costs to the regulated entity where many ratepayers are still captive. Finally, price caps do not automatically make current RBOC rates "reasonable," but rather only impose certain limits on the RBOCs' ability to increase rates for certain services. The Commission's price caps rules are without power to somehow make current RBOC rates cost-based, and thus reasonable. In short, the existence and strength of the FCC's nonstructural safeguards should not depend on the status of price caps.

⁷⁵ Notice at para. 120.

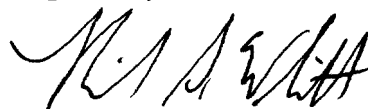
⁷⁶ Notice at paras. 121, 124.

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V. CONCLUSION

The Commission should act in accordance with the recommendations proposed herein.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Cecelia Y. Johnson, hereby certify that I have this 26th day of August, 1996, sent a copy of the foregoing "Further Comments of LDDS WorldCom" by hand delivery, or first class mail, postage prepaid, to the following:

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